VZCZCXYZ0011
RR RUEHWEB

DE RUEHBO #2017 1741931
ZNR UUUUU ZZH
R 231931Z JUN 09
FM AMEMBASSY BOGOTA
TO RUEHC/SECSTATE WASHDC 9516
INFO RUEHBR/AMEMBASSY BRASILIA 8991
RUEHCV/AMEMBASSY CARACAS 2356
RUEHLP/AMEMBASSY LA PAZ JUN LIMA 7659
RUEHQT/AMEMBASSY QUITO 8356
RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOC/DEPT OF COMMERCE WASHDC

UNCLAS BOGOTA 002017

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: ECON EFIN CO
SUBJECT: GOC SCRAMBLES TO DEAL WITH GROWING BUDGET WOES

¶1. SUMMARY. (U) After several years of steady growth, the global economic crisis is hitting GOC coffers and generating a newly projected 2009 central government deficit of $7 billion (3.7% of GDP), and a 2010 estimate of $11 billion (4.3% of GDP). With continuing obligations in infrastructure, defense, social services and education, the fall in tax revenues is squeezing government accounts. The GOC has floated a package of new taxes, increased borrowing and budget cuts to cover the shortfall, including changes to the government's "wealth tax" imposed to help fight terrorism. The crisis has put a spotlight on GOC policies of offering generous tax breaks utilized to lure increased domestic and international investors, one assailed by critics for limiting governmental tools to maximize revenue. END SUMMARY.

Faltering Tax Receipts, Growing Deficit

¶2. (U) The Ministry of Finance now projects Colombia's growth for 2009 to fall to 0-0.5% from 2.5% in 2008. Falling tax revenues will put the deficit at 3.7% of GDP in 2009 (up from 2.4% in 2008) and an anticipated 4.3% of GDP in 2010. The GOC is considering a package of budget cuts, tax hikes and external borrowing to cover the shortfall. On the budget side, the GOC will reduce public investment spending from $5 billion in 2009 to $4.2 billion in 2010. The conditional cash transfer program "Familias en Accion", that currently provides assistance to 2.6 million Colombian families, will not expand as planned to 3 million families in 2010. There is also speculation that more cuts might come in education, environment, science and technology, and possibly health care. Finance Minister Zuluaga announced that the GOC will seek an additional $1.5 billion in bonds--coming on the heels of a $1 million issuance in January--as well as a $12.9 billion emission of local treasury certificates.

¶3. (SBU) The tax picture is more complicated. The GOC is considering several potential measures, all fraught with political difficulties as the 2010 election approaches. The most likely scenario is making permanent the temporary "wealth tax", utilized to support increased expenditures on domestic security. Sergio Clavijo of the National Association of Financial Institutions (ANIF) suggests lowering the gross capital threshold at which the 1.2% tax applies to USD $100,000 from USD $1.5 million. Mauricio Santamaria of leading think-tank Fedesarollo argues for a complete tax reform to simplify the value-added tax, eliminate employer assessments that fund worker programs, limit hemorrhaging tax exemptions, and lower the corporate tax rate. He claims that such a proposal would increase revenues by 2% of GDP, but acknowledged that President Uribe has never been a friend of such sweeping reforms.

Tax Breaks Under Fire

¶4. (SBU) Fiscal woes have fed growing criticism of GOC policies to expand free trade zones and enter into "judicial stability" contracts that guarantee investors a defined tax treatment for a 20-year period. ANIF's Clavijo estimates that these policies cost the central government some $3.5 billion annually in lost revenues, a situation that Colombia's former tax administration director calls "a tale of a gap foretold." Beyond reduced revenue, these policies severely limit the options GOC policymakers have at their disposal to increase revenues. Former World Bank Chief Economist Guillermo Perry has been a particularly severe critic of the government's measures. He argues -- a view supported by a consultative group of ex-Ministers of Finance -- that the favorable external environment and improved security are sufficient motors to spur investment, and that the "additional stimulus (is) unnecessary and rather imprudent given the existing high central government deficit and public debt levels." American Chamber of Commerce Executive Director Miguel Gomez, while admitting that the focus on investment-led job creation is important in these difficult times, concurs that the web of subsidies and differential tax rates has helped put public finances in a bind.

Brownfield